The challenges and opportunities for Islamic Banking in Pakistan

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State Bank of Pakistan
## Islamic Banking in Pakistan-Current Status

### Industry Progress and market share

<table>
<thead>
<tr>
<th></th>
<th>Mar. 10(^{^\text{a}})</th>
<th>Dec. 09</th>
<th>Dec. 08</th>
<th>Dec. 07</th>
<th>Dec. 06</th>
<th>Dec. 05</th>
<th>Dec. 04</th>
<th>Dec. 03</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total Assets</strong></td>
<td>371</td>
<td>366</td>
<td>276</td>
<td>206</td>
<td>119</td>
<td>72</td>
<td>44</td>
<td>13</td>
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<tr>
<td>Share in industry</td>
<td>5.8</td>
<td>5.6</td>
<td>4.9</td>
<td>4</td>
<td>2.8</td>
<td>2</td>
<td>1.5</td>
<td>0.5</td>
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<tr>
<td>Growth</td>
<td>33.3</td>
<td>32.7</td>
<td>34.0</td>
<td>73.1</td>
<td>65.3</td>
<td>63.6</td>
<td>238.5</td>
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<tr>
<td><strong>Deposits</strong></td>
<td>289</td>
<td>283</td>
<td>202</td>
<td>147</td>
<td>84</td>
<td>50</td>
<td>30</td>
<td>8</td>
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<tr>
<td>Share in industry</td>
<td>6.1</td>
<td>5.9</td>
<td>4.8</td>
<td>3.8</td>
<td>2.6</td>
<td>1.8</td>
<td>1.3</td>
<td>0.4</td>
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<tr>
<td>Growth</td>
<td>40.2</td>
<td>39.9</td>
<td>37.4</td>
<td>75.0</td>
<td>68.0</td>
<td>66.7</td>
<td>275.0</td>
<td></td>
</tr>
<tr>
<td><strong>Net Financing &amp; Investment</strong></td>
<td>229</td>
<td>226</td>
<td>186</td>
<td>138</td>
<td>73</td>
<td>48</td>
<td>30</td>
<td>10</td>
</tr>
<tr>
<td>Share in industry</td>
<td>4.6</td>
<td>4.5</td>
<td>4.3</td>
<td>3.5</td>
<td>2.3</td>
<td>1.7</td>
<td>1.3</td>
<td>0.5</td>
</tr>
<tr>
<td>Growth</td>
<td>25.5</td>
<td>21.3</td>
<td>34.8</td>
<td>89.0</td>
<td>52.1</td>
<td>60.0</td>
<td>200.0</td>
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<tr>
<td><strong>Total Islamic Banking Institutions</strong></td>
<td>19</td>
<td>19</td>
<td>18</td>
<td>18</td>
<td>16</td>
<td>11</td>
<td>11</td>
<td>4</td>
</tr>
<tr>
<td><strong>Total No. of Branches</strong></td>
<td>654</td>
<td>651</td>
<td>515</td>
<td>289</td>
<td>150</td>
<td>70</td>
<td>48</td>
<td>17</td>
</tr>
</tbody>
</table>

*Source: Annual Accounts except for March 2010, data for which is based on Unaudited Quarterly Accounts

**Number includes sub-branches

^Growth for March 2010 is YoY
Islamic Banking in Pakistan-Current Status

• Three types of IBIs
  – Full fledge Islamic banks
  – Islamic banking subsidiaries of conventional banks
  – Islamic banking branches of conventional banks

• 6 full-fledged Islamic banks and 13 conventional banks having Islamic banking branches

• Branch network - over 650 branches with presence in over 80 cities & towns

• Market share- 6%, starting from scratch in 2001, likely to be doubled in next 3 years
Current Status

• An elaborate Shariah Compliance Framework
  – Central Shariah Board at Central Bank
  – Shariah Advisors at banks’ level
  – Fit and proper criterion for Shariah Advisors
  – Shariah Advisors’ forum
  – On-site examination of IBIs along with normal regulatory examination to check Shariah compliance
  – Model agreements for essential modes of Islamic finance

• Supportive Central Bank

• Tax Neutrality
Opportunities

- A reasonably large country with 170-180 million people predominantly Muslim;
- A general disliking for interest (Riba) based banking system;
- Anecdotal evidence suggests a significant proportion of masses and business community remain out of banking system due to Riba based system
- If offered a competitive solution most of the existing clients of conventional system would opt for Islamic finance
- Limited penetration of conventional banking system; only 14% of the population uses the formal financial system; thus a huge untapped market is available for IBIs to tap; 19 percent of the population does not use any finance voluntarily (formal or informal) the reasons among others include religious

(Bringing finance to Pakistani Poor (http://siteresources.worldbank.org/INTFR/Resources/Paper-NenovaNiangandAhmad.pdf))
Opportunities

- Only 0.2 million SMEs availed financing out of 3.1 million SMEs across the country; the IBIs have just around 2300 SME clients
- About 1.85 million farm households obtained bank loans (outstanding) out of more than 6 million farm households in the country with almost negligible from IBIs
- Gross shortage of warehouses and cold storages for agri-produce, which could be financed through Islamic modes
- Huge potential for food processing industries; about 40% of fruits and vegetables are perished due to limited food processing industry and non-availability of proper storage facilities
- Grossly low level of mortgage financing- less than 1% of GDP; IBIs can tap this market through DM like products
- Limited availability of investment banking and project financing institutions; the gap which can be bridged by IBIs
Challenges

• Low Islamic banking literacy
• Limited HR Capacity
• Blurring Distinction b/w Islamic and Conventional Banking
• Current Paradigm- Competition with Con. Banks
• Low Product Innovation and diversification
• Liquidity Management issues
• Islamic pricing benchmark
• Increasing MCR-Stressing IBIs profitability
• Making Islamic Banking a part of National Agenda
Strategy to address the challenges

• Improving Islamic banking literacy
• Capacity building of sector
• Improving Shariah Compliance Framework
• Product Diversification, economies of scale and scope
• Gradual movement towards participatory modes of finance
• Liquidity management solutions
Awareness Strategy

Programs for:
- Sr. SBP and Conventional banks’ management
- Business Community
- Government Departments/Ministries
- Accounting & taxation community
- Legal community
- Academia
- General Public
- Translation of Islamic banking guidelines, product features etc in Urdu and regional languages for wider dissemination
- Encouraging IBIs to organize frequent awareness programs for business community to allay their apprehensions about Islamic finance
Capacity Building

- NIBAF (Central Bank subsidiary for Training and Capacity building) courses frequency and periodicity
- Developing linkages with reputed educational institutions to improve supply of qualified Islamic finance professionals;
- Training of Shariah Advisors
- Collaboration with international, regional and local institutions for initiating customized training programs for IBIs
- Technical Assistance from IDB/IRTI
- Trainings of Sr. Mgmt of IBIs
- Encouraging religious schools to include courses on banking, accounting and finance in their regular Shariah curriculum
Participatory modes

- Increasing awareness about benefits of participatory modes amongst the business community
- IBIs’ capacity Building in Participatory modes;
- Establishing Musharaka Divisions in IBIs;
- Possibility of introducing external ratings of entrepreneurs and their projects to be financed under Musharaka
- Third party audit of operating results of the projects
- Transaction based Musharaka
Liquidity Management

- Development of Short term Govt. Sukuk in liaison with GOP
- Possibility of devising a mechanism for allowing IBIs to place surplus liquidity with the Central Bank being evaluated
- Development of Islamic Interbank Money Market
- Lender of last resort facility
- Commodity Murabaha
- Conducting/Sponsoring Studies for Developing innovative Shariah compliant products for financing govt. budget deficit
- Shariah Compliant alternate of deposit protection scheme
Shariah Compliance

- Strengthening of SBP Shariah Board
- Adoption/adaptation of AAOIFI Shariah Standards
- Strengthening of internal Shariah Audit at IBIs
- Introduction of External Shariah Audit
- Introduction of Shariah Ratings
- Strengthening Shariah Inspection by SBP
- One time special Shariah Inspection and Enforcement
- Development of penalty scale for IBIs on Shariah instructions